# A STRATEGY AND ACTION PLAN TO ASSIST SMES IN ADJUSTING TO SPS STANDARDS

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# Executive Summary

Small-and medium-size enterprises (SMEs) will face both challenges and opportunities from Ukraine's accession to the World Trade Organization (WTO). Opportunities for exporting Ukrainian products to new countries will increase significantly. At the same time, products being exported to other countries will be expected to comply with international sanitary and phytosanitary (SPS) standards and in particular, the standards of the Codex Alimentarius Commission (Codex). The latter often is a significant challenge for SMEs.

To assist Ukrainian SMEs to adapt to the new SPS legal framework and enhance their ability to export food products to WTO members, assistance will be provided in several areas. Based on a review of the business environment in Ukraine and experiences of food industry SMEs elsewhere, the following will be implemented:

- Identify general constraints and devise solutions to enable SMEs to adjust to Codex standards, including general technological requirements, sanitary/hygienic conditions, and food production and analytical control methods.
- Develop and disseminate to SMEs sector-specific manuals for three sectors for complying with various international SPS norms based on best practices and experience of SMEs elsewhere.
- Promote business-to-business partnerships to provide SMEs with guidance on firm-specific issues associated with adoption of international standards in order to participate in supply chains.
- Help develop SMEs' capacity to compete in the market by:
  - delivering training sessions to food industry SME representatives on the advantages of food processing in compliance with international food hygiene and safety requirements and management systems;
  - training trainers from food industry associations to assist members with the adoption of international standards;
  - disseminating information to SMEs via websites and food associations and to farmers and farmer organizations in cooperation with the USAID-funded Farmer-to-Farmer program.

Compliance manuals will be developed for the meat processing, dairy products and vegetable oils production sub-sectors of the food products industry. Vegetable oils are major export products of Ukraine, with growth since 2002 averaging 20 percent per year. Dairy products are also major export products that are growing at an average annual rate of more than 30 percent. Processed meat products (sausages) are popular consumption products that account for more than half of the retail turnover of meat in Ukraine. Dairy products and processed meat products are among the highest risk food products, meaning that they are more likely than other food products to cause illness or other health concerns. Therefore, these three sectors represent a combination of widely produced domestic products, major export products and have significant food safety concerns.

The proposed SME assistance will be designed to provide a basis from which assistance may be provided to other food product sectors. While training events will be important, it is business-to-business partnerships, training of trainers from food industry associations and dissemination of food safety standards and other relevant information via websites, food associations and farmer-to-farmer organizations that will provide a strong foundation from which further assistance to SMEs may be provided.

# Ukrainian SMEs and Food Safety Issues

The new SPS legal framework developed for WTO accession will enable Ukraine's state sector to establish an internationally competitive agriculture and food industry. The change in the state's role from director to overseer places a greater burden on the private sector to ensure the safety or pest-free or disease-free status of their products. Several Ukrainian food product enterprises that are successfully exporting food products are already familiar with the concept of ensuring food product safety and other international SPS standards and requirements. Many more Ukrainian agricultural and food sector entrepreneurs and enterprises are not aware of international SPS standards. This can be a significant challenge for small- and medium-size enterprises (SMEs).

According to the 2005 edition of the *Business Environment in Ukraine*[1], regulatory procedures—especially those associated with taxation, permits and inspections—and corruption were found to be serious or very serious obstacles for 61 percent of surveyed SMEs. Further, half of survey respondents had problems with government intrusion in their businesses. And, frequent changes to legislation created a problem for 78 percent of the businesses surveyed.

SMEs are plagued by redundant and inefficient state inspections—78 percent of responding enterprises were inspected in 2004, each undergoing nine inspections on average. The costs associated with inspections were a total of UAH 500 million, including fines and unofficial payments, an average of almost UAH 200,000 per surveyed enterprise. Since fines are imposed for violations of regulatory requirements, reducing such violations will have a significant effect on SMEs' profitability.

Only 6 percent of the SMEs surveyed exported products. Of these enterprises, 44 percent reported that differences in standards (Ukrainian standards versus international standards) affected their ability to participate in export markets. In addition, 43 percent noted that their inability to obtain a quality certificate inhibited their ability to export. SMEs that did export goods tended to have more employees. The difference was significant enough for the survey authors to conclude that the number of employees had more weight than sales revenue in the decision to export. Export capacity of micro- and small firms (those with 50 or fewer employees) was limited and was due to lack of employees who could devote enough time to overcoming regulatory and administrative barriers.

Another problem related to limited human resources was that most exporting firms either did not actively market to potential foreign clients or they tended to rely only on partner recommendations and the Internet. While most surveyed firms had access to the internet, only one-third had a website. Only 6 percent of the respondents exporting used information available from Ukrainian embassies abroad, and 26 percent obtained information from the Ukrainian Chamber of Commerce and Industry (UCCI). The latter finding suggests that either SMEs are not members of the UCCI or, if they are members, they do not rely on the UCCI to assist with exporting. In the latter case, promoting the use of UCCI resources to assist in exporting may be particularly beneficial to SMEs.

The findings from the IFC survey of SMEs suggest that broader dissemination of regulatory requirements, particularly with respect to inspections (inspection objectives), increasing the ability of SMEs to obtain quality certificates, and increased ability to meet international standards will reduce financial burdens and labor constraints and increase the ability of SMEs to benefit from WTO membership.

The survey of Ukrainian SMEs encompassed a wide range of enterprises, with food processors classified within the manufacturing category. Unfortunately, no survey has been conducted of food sector SMEs. However, two recent studies—one from Australia and the other from the UK—suggest that the IFC survey results probably apply quite well to food sector SMEs.

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[1] Published by the Ukraine SME Policy Development Project implemented by the International Finance Corporation.

A roundtable to obtain the perspective of SMEs for improving the food safety framework in New South Wales (NSW), Australia, was held in 2005[2]. Representatives from agricultural product producers, processors, packers and suppliers of inputs and equipment to SMEs identified inspections (multiplicity, inconsistency and effectiveness), need for simplicity in regulations, need for practical guidance and need for operator training as significant issues. Specifically, the roundtable participants identified the following as desirable:

- Ongoing consultation and communication between state authorities and SMEs;
- Better integration of state authorities inspection/auditing with local government and independent auditors;
- Training in responsible food handling;
- Practical guidance for SMEs, particularly from larger enterprises in the food products sector;
- Relating food safety to the bottom line; and
- Promotion of best practice (by SMEs and other companies).

A comprehensive study of factors affecting food safety compliance within SMEs was conducted in the UK[3]. Principle barriers to compliance were, among other things, found to be:

- Lack of motivation or interest;
- Perceived lack of relevance;
- Lack of knowledge; and
- Lack of awareness of the relevance of legislation

The authors of the study noted that 42 percent of SMEs did not understand what "hazard analysis" meant, what it required them to do, how to implement it into their business or how to evaluate and monitor steps taken to reduce hazards. In addition, there was a lack of understanding of both the legislation and basic food safety principles. Further, SMEs demonstrated a lack of trust in legislative requirements and in inspections and inspectors. Nearly two-thirds disagreed with requirements imposed by inspectors following an inspection because they were felt to be irrelevant to food safety. Many also felt that inspectors raised petty issues and were inconsistent from one inspection to another and across businesses.

By superimposing the food sector specific findings from the UK and Australia on the Ukraine SME survey findings, several issues stand out. First, lack of knowledge about and changes in regulatory requirements, including the relevance of regulatory requirements, are problematic for SMEs, as is knowledge about food safety principles. Second, inspections are very burdensome, both in terms of time and financial consequences. Third, differences in standards between Ukraine and those applying in export markets, and inability to obtain quality certificates negatively affected exporting SMEs' ability to conclude export sales.

The common themes noted above suggest that SMEs in Ukraine will benefit significantly from support in four principal areas:

- Identification of constraints to adoption and application of international SPS standards and development of means for eliminating or reducing such constraints;
- Education in basic food safety principles, including technology and sanitary/hygiene practices, with emphasis on how their application by SMEs can minimize inspections;
- Introduction of international SPS standards (codes of hygienic practice, good agricultural practices) in food sector SMEs; and
- Promotion of SME partnerships with large enterprises in the food products sector to assist with adoption of international standards in order to participate in supply chains.

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2 *Improving the Food Safety Framework in NSW – An SME Perspective,* discussion paper resulting from a NSW Food Safety Roundtable on 13 April 2005 (http://www.foodauthority.nsw.gov.au).

3 Yapp, Charlotte and Robyn Fairman, "Factors affecting food safety compliance within small and medium-sized enterprises: implications for regulatory and enforcement strategies", *Food Control*, Volume 17, Issue 1, January 2006, pp 42-51.

### *Identification of Constraints and Development of Means for Reducing Constraints to Adoption of International SPS Standards*

To identify constraints to adoption of international SPS standards by SMEs in the food products industry, the IFC survey results can be used as a starting point. In addition to the factors identified in the IFC survey as constraints to SME development, factors specific to the food products industry must be considered. This requires assessment of SMEs' knowledge of international SPS standards such as codes of hygienic practice, basic food handling procedures, and so on, and their perception of such standards with regard to their specific businesses. In particular, constraints imposed on SMEs due to the availability of technology (equipment, access to accredited laboratories, etc.) or ability to acquire such technology must be assessed. Food industry associations can be of particular help in providing preliminary information on constraints and identifying SMEs that are representative of their members.

Once these constraints are identified, means of reducing the constraints can be devised. This may include producing educational material on widely-applicable international SPS standards or identifying typical equipment or technologies that will enable greater adoption of international standards. The specific nature of proposed remedies will depend on the identified constraints. Similar to the case when identifying constraints, food industry associations can assist in identifying solutions given the current state of Ukrainian businesses.

### *Education in Basic Food Safety Principles and How their Application Can Reduce Inspections and other Regulatory Burdens*

Basic food safety principles must underlie the day-to-day operations of food products industry SMEs in order to establish a foundation for adoption of international SPS standards. These basic principles include, for example, hygiene (of staff, contact surfaces, facilities), temperature control for perishable food products, use of approved substances in food processing or producing enterprises, and expectations of buyers of SMEs' products with regard to guarantees of safety. Food industry associations can assist in identifying the best means of disseminating educational material to relevant SMEs (e.g., websites where information can be obtained and/or printed, publication of brochures, internet courses, etc.). Farmers and farmer organizations will be included in the educational program through cooperation with the USAID-funded Farmer-to-Farmer program implemented by the Citizen Network for Foreign Affairs (CNFA).

The education element of the action plan will include:

- Two training sessions to food industry SME representatives on the advantages of food product processing in compliance with international food hygiene and safety requirements and management systems; and
- To ensure continuing support to SMEs, two training-the-trainers sessions for representatives from food industry associations will be provided to assist their members with the adoption of international standards.

With regard to the first training objective, the advantages of employing basic food safety principles derived from international SPS standards will be demonstrated by working with relevant state authorities to identify which international standards, when applied by SMEs, establish confidence on the part of regulatory bodies in SMEs' ability to consistently produce safe food products. In addition, clear guidance on interpretation of regulatory requirements will be provided, when possible, to assist SMEs in establishing a solid foundation for reducing the number and/or frequency of state-mandated inspections of SMEs.

### *Introduction of International SPS Standards in Specific Food Sector SMEs*

In order for SMEs to benefit the most from introduction of international SPS standards, information tailored to specific sectors will be of the greatest value. Good agricultural practices, which should be the base for the farm-to-fork approach to food safety, will not be of interest to vegetable oil producers or other food processors. Likewise, codes of hygienic practice for the meat sub-sector will have no relevance for most other food product sub-sectors. At the same time, it is not possible to provide comprehensive information and support to all agricultural and food product sub-sectors. Therefore, support will be provided to three specific sub-sectors with the intent of providing a basis from which subsequent support can be provided.

When choosing sub-sectors in the agricultural and food products industries, there are three relevant considerations. First, since the support to SMEs is to enhance their development, it is important to choose sub-sectors within which there is significant domestic production of foodstuffs. Second, due to limited population growth in Ukraine and enhance opportunities from WTO membership, sub-sectors that are currently generating export revenue are good choices. Third, since a complementary focus of the support activity is to implement the new SPS legal framework, the significance of the sub-sector with respect to food safety risk is important. These factors will be examined in the next section in order to identify sub-sectors within which SME support will be provided.

Since few Ukrainian SMEs are exporting at present, production for the domestic market is of primary interest for most enterprises. According to data available from the State Statistics Committee of Ukraine[4], circulation of meat and meat products accounts for the largest share of retail turnover of foodstuffs, followed by confectionery products, bread and bakery products, milk and dairy products, and fats and oils (see Table 1). Since more than 95 percent of food products consumed in Ukraine are produced domestically, the turnover statistics can be used as an indicator of domestic production of different foodstuffs.

When reviewing Ukraine's agricultural and food product exports, the picture is very similar. More than three-quarters of the average value of exports of all agricultural and food products during 2005-2006 fell into the categories of cereals, oilseeds, vegetable oils, dairy products, beverages and cocoa and cocoa products (see Table 2). Export revenue from these products averaged US$3.5 billion during 2005-2006, rising at an astounding rate of 25.5 percent per annum, from US$1.7 billion in 2002 to US$3.7 billion in 2006.

Table 1 - Retail Trade Turnover of Foodstuffs (Million UAH)

| | 1995 | 2000 | 2001 | 2002 | 2003 | Share of foodstuffs |
|---|---|---|---|---|---|---|
| Foodstuffs[1] | 7,435 | 13,819 | 15,836 | 17,217 | 20,349 | |
| Meat and products | 1,198 | 1,788 | 2,114 | 2,253 | 2,735 | 13.4% |
| Fish and seafood | 245 | 453 | 557 | 640 | 813 | 4.0% |
| Vegetable and fruit canned | 119 | 161 | 206 | 270 | 368 | 1.8% |
| Fats | 478 | 543 | 644 | 706 | 809 | 4.0% |
| Milk and dairy | 353 | 627 | 745 | 857 | 1,044 | 5.1% |
| Cheese and brines | 117 | 188 | 241 | 285 | 403 | 2.0% |
| Eggs | 137 | 232 | 290 | 338 | 369 | 1.8% |
| Sugar | 262 | 254 | 251 | 279 | 315 | 1.5% |
| Confectionery | 561 | 1,231 | 1,444 | 1,622 | 1,797 | 8.8% |
| Tea, coffee | 60 | 229 | 279 | 363 | 493 | 2.4% |
| Bread and bakery products | 1,330 | 1,898 | 1,769 | 1,457 | 1,466 | 7.2% |
| Flour, cereals, and pasta | 357 | 588 | 533 | 529 | 686 | 3.4% |
| Vegetable and fruit fresh | 350 | 382 | 433 | 521 | 740 | 3.6% |
| Other foodstuffs | 1,869 | 5,246 | 6,331 | 7,097 | 8,311 | 40.8% |

[1] Excluding tobacco products.
*Source: State Statistics Committee of Ukraine*

[4] As reported by the Foreign Agriculture Service, U.S. Department of Agriculture, in "Ukraine Retail Food Sector: Retail Chains on the Rise", 15 November 2006, GAIN Report UP5020.

Table 2 - Agricultural and food product exports from Ukraine (ranked according to value)

| FEA chapter | Description | Average exports (Mil US$) | | Growth[1] (%) | Share (%) | |
|---|---|---|---|---|---|---|
| | | 2002-03 | 2005-06 | | Of total[2] | Cumulative |
| 10 | Cereals | 700.0 | 1,368.7 | 25.0% | 30.4% | 30.4% |
| 15 | Animal, vegetable fats and oils, etc | 450.5 | 779.3 | 20.0% | 17.3% | 47.6% |
| 04 | Dairy products, eggs, honey | 197.7 | 447.0 | 31.3% | 9.9% | 57.5% |
| 22 | Beverages, spirits and vinegar | 125.0 | 418.2 | 49.6% | 9.3% | 66.8% |
| 18 | Cocoa and cocoa preparations | 139.3 | 249.6 | 21.5% | 5.5% | 72.4% |
| 23 | Residues, wastes of food industry, feed | 95.4 | 154.9 | 17.5% | 3.4% | 75.8% |
| 20 | Vegetable, fruit, nut, etc preparations | 61.8 | 127.0 | 27.1% | 2.8% | 78.6% |
| 12 | Oilseeds | 153.0 | 224.9 | 13.7% | 5.0% | 83.6% |
| 08 | Edible fruit, nuts, citrus peel, melons | 40.0 | 126.9 | 46.9% | 2.8% | 86.4% |
| 17 | Sugars and sugar confectionery | 155.7 | 111.8 | -10.4% | 2.5% | 88.9% |
| 19 | Cereal, starch, milk preps and prods | 39.7 | 106.3 | 38.9% | 2.4% | 91.3% |
| 24 | Tobacco and tobacco substitutes | 49.7 | 99.8 | 26.2% | 2.2% | 93.5% |
| 02 | Meat and edible meat offal | 225.8 | 93.8 | -25.4% | 2.1% | 95.5% |
| 07 | Vegetables and roots and tubers | 20.2 | 63.0 | 46.0% | 1.4% | 96.9% |
| 21 | Miscellaneous edible preparations | 42.3 | 49.5 | 5.4% | 1.1% | 98.0% |
| 11 | Milling products, malt, starches, etc. | 16.8 | 32.7 | 24.9% | 0.7% | 98.8% |
| 16 | Meat, fish and seafood preps nes | 16.5 | 25.4 | 15.6% | 0.6% | 99.3% |
| | Other agricultural and food products | 31.1 | 30.3 | -0.9% | 0.7% | 100.0% |

[1] Average annual growth rate for the average of 2002-2003 to the average of 2005-2006.
[2] Share of total value of agricultural and food product exports (FEA chapters 01-24).
*Source: UN COMTRADE (http://comtrade.un.org/db/default.aspx)*

From an SPS perspective, assistance to those SMEs which produce food products most likely to present food safety hazards will be most beneficial. Animal products are among the highest risk food products. As a consequence, animal products are subject to numerous safety criteria for both domestic consumption and international trade. Based on the above assessment of domestic retail turnover (as a proxy for domestic production), agricultural and food product exports, and SPS concerns, the three food industry sub-sectors that will be targeted for special assistance are:

- Meat processing;
- Dairy (milk) products; and
- Vegetable oils.

For each of the meat processing, dairy products and vegetable oils sub-sectors, manuals for complying with critical Codex international standards based on best practices and experience of SMEs elsewhere will be developed and disseminated to SMEs. Each manual, tailored to a specific sub-sector, will include, in particular:

- Basic good manufacturing practices associated with:
  - Personnel;
  - Buildings/facilities;
  - Equipment; and
  - Production and process controls.
- Safety and quality assurance systems, including:
  - Sources of food product contamination;
  - Risk of contamination;
  - Controlling risks; and
  - Controlling quality.
- Guidance on standards and conditions specific to the Ukrainian industry (e.g., use of food additives, flavorings, etc.).

### *Promotion of Business-to-business Partnerships to Assist with Adoption of International Standards to Participate in Supply Chains*

A considerable amount of both national and international trade in food products, similar to the case of many industrial products, is conducted through supply chains. Businesses that participate in supply chains tend to be highly reputable, offering a consistent quality and safety guarantee to their buyers. Once businesses break into the supply chain, they are far more likely to sustain and build their businesses than enterprises that do not participate in supply chains.

It is clear from Ukraine's agricultural and food product export profile that some businesses are very successful exporters that are experiencing increasing demand for their products abroad. A similar statement can be made with regard to retail turnover of foodstuffs, which has been increasing rapidly since 2000. Many of the enterprises that are behind these very positive trends in food product sales very likely are participating in supply chains, while those that are not participating in supply chains must have another recipe for success. Either way, these enterprises can be a tremendously valuable resource for Ukrainian SMEs. Therefore, promotion of business-to-business (B2B) partnerships to assist with adoption of international standards will be a critical component of the action plan.

To begin establishing B2B partnerships, successful Ukrainian and multinational food product companies will be approached through the UCCI or relevant food industry associations to gauge their willingness to assist SMEs. Those enterprises that are willing to assist SMEs may do so in many different ways. For example, enterprises that have their own supply chains may be willing to make presentations to UCCI or food industry association members outlining their criteria for inclusion of SMEs in their supply chains. Enterprises that have entered either domestic or international supply chains may be willing to provide seminars describing what they did in order to participate in such chains. Some enterprises may be willing to participate in training events while others may host visits to their processing enterprises by SMEs to see how they have implemented international SPS standards in their businesses. Based on the interests and willingness of successful enterprises, a more detailed work plan will be developed and implemented.

B2B partnerships among SMEs will also be pursued. For example, development of an ongoing network of interested SMEs to share information about effective approaches to adoption of international SPS standards, emerging issues, available technologies and other issues can be an effective channel of support for SMEs. Food industry associations may be particularly helpful in designing this type of network among its members.